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special credit facilities and priorities in using tractor stations, and were favoured in many other ways. In spite of these benefits and a relentless propaganda coupled with elaborate methods of pressure, land collectivization remained in an embryonic stage. By the end of 1949 it was claimed that about 1,500 producers' co-operatives, cultivating 370,000 yokes of land, had been established. This would amount to 2·6 per cent of the total agricultural area. Even these moderate figures may be overstatements, as possibly not all the co-operatives concerned are of the most 'advanced' type, which merges the holdings of the individual members. Moreover, this kind of co-operative was mostly established on land recently acquired by the Government under the right of pre-emption, or through confiscating *kulak* holdings, and redistributed on condition that the new owners joined the advanced form of co-operative.

So far the changes in the organization of agriculture as brought about by the land reform were slight. Yet the rural districts had been stirred up and their atmosphere poisoned. Some detrimental influence on productive activity may eventually result, but no signs of it have been discernible up to now. The reports on the achievement in agriculture neither substantiate accusations of *kulak* sabotage nor do they indicate any relaxation of assiduity in cultivation because of anxiety about the ownership of land. The terror applied in collecting the grain and other produce, which the peasants were bound to deliver in order to ensure public supply, may partly explain their zeal in growing adequate quantities.

ADOPTION OF THE SOVIET PATTERN IN BANKING

In April 1948, with any serious political opposition already excluded, it was proposed to recast the Hungarian credit organization. By that time the nationalization of the leading banks had been completed. As already stated that measure, extending as it did to the subsidiaries of the institutes concerned, subjected over 80 per cent of the credit apparatus to public control. Nationalization, as it was decided upon in 1947, was intended to avoid the disruption of existing units, and to enable them to restore former international relations. A reorganization of banking undeniably appeared necessary. It was already overdue during the inter-war period, when the solution of the problem was adjourned because of the rivalries of competing groups and the lack of determination of the financial authorities. There is little doubt that a reasonable organization could have been reconciled with the preservation of ties with Western

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652 453 financial markets. Yet the break-up that ensued was calculated to sever existing links. The new State banking system was introduced gradually as from May 1948, and the old structure disappeared.

The entire current banking business was transferred to the National Bank which took over the assets and the liabilities of the other banks. Thus the Central Bank, endowed with the right of note issue, was turned into the exclusive source of credit. It provided enterprises directly with working capital through the instrumentality of the 'single-account' system. For an enterprise placed under this system, the National Bank had the monopoly of banking services. All its financial transactions had to pass through its single account. In particular loans providing working capital were credited to it.[1] From the outset nationalized enterprises and other public concerns came under the system. Any private enterprise, applying for credit to the National Bank or to the Treasury, might be drawn in, thereby being practically placed under public control.

Thus the National Bank came to provide for the financial requirements of the publicly-owned concerns and, to a considerable extent, also of those privately owned. For the residue of credit operations certain other institutions are assigned.

(1) An Investment Bank was established to finance and control investment activities in mining, industry, transport, and in important branches of building. The Bank is practically the financial section of the Planning Department. The funds at its command are derived first of all from the central and local government budgets. The amounts earmarked in these budgets for investment are transmitted to the Bank. It has at its disposal another source to draw upon for the purpose of allocating long-term credits: the National Bank. Finally it is the Investment Bank that handles the depreciation fund of Hungarian industry. All enterprises—public and private—pay regular contributions to this fund in proportion to their sales.[2]

652 457 (2) The Bank of International Trade was endowed with the monopoly of banking transactions connected with foreign trade. One of the former big Budapest banks, which, like the other banks, had already handed over all the other parts of its business to the National Bank, was established in this special capacity. However, in one respect the monopoly of the Bank for International Trade appears to be restricted; in transactions with Soviet Russia it is required to co-operate with the Russian-owned Hungarian Bank of Commerce and Industry.

652 453 (3) The National Savings Institution first operated as a section of the National Bank. In a second phase the section was promoted to

[1] The purport of this system from the point of view of financial control will be discussed in Chapter IX.

[2] See comments on p. 86, below.

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be a separate institution, a change which did not substantially alter the former position. In it, the savings banks of the country, including the Postal Savings Bank, were merged. Besides collecting deposits through its network of branch offices, it acts as a bank for private enterprise. It grants short-term credits to small-scale industries and retail trade. But the credits granted fall short of the deposits collected, and the excess is transferred to the National Bank to support the credit operations of the latter. According to an expert statement the direct lending of the Savings Institution amounted to hardly 10 per cent of total deposits in July 1949.

(4) The Bank of Co-operative Societies, a long-established centre for co-operative credit, acts as the bank for agriculture. Though it receives deposits, this branch of its activity has so far shown poor results, and it depends, therefore, for capital resources on the National Bank.

Outside the Hungarian banking system the Russian-owned Bank already referred to enjoys a status of *de facto* extra-territoriality. It is the banker of the various Russian enterprises, headed by an agency for the management of Russian property. The Bank was originally Austrian-owned, and was taken over by the Russians in pursuance of their interpretation of the Potsdam Agreement. Other foreign banks were wound up, as no scope was left for their activities.

From any description of the banking system of Soviet Russia it is clearly seen that the Hungarian Communists faithfully fulfilled their task of copying the Russian organization. The State Bank, as the sole institution for short-term credit, and around it a few specialized agencies as distributors of the funds made available for planned investments, are the characteristics of the credit system adopted in the Soviet Union in 1930.[1] However, when building up the new system, there was a fundamental difference between what had to be done in Russia on the one hand and what in Hungary on the other. The Russian Bolsheviks had to fill a vacuum, as vast territories under their rule were without any credit organization. The Hungarian Communists had, on the contrary, first to destroy a fairly well developed credit system before introducing the new pattern.

It was a peculiar incident in the course of the Three-year Plan that the pattern of economy changed during its progress. To initiate these changes was a daring experiment, which amounted, in fact, to an alteration of the steering mechanism while under way.

The following table shows the progress of nationalization in the course of the Three-year Plan.

[1] Alexander Baykov, *The Development of the Soviet Economic System: an essay on the experience of planning in the U.S.S.R.* (Cambridge University Press, 1946).

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restricted by controls and rationing. But controls must be strict, and the average income level must be high enough to leave a margin after covering the rationed products. These conditions were not present in Hungary. The Government were the more intent on encouraging voluntary thrift, in the hope of closing the gap between the amount of investment and the surpluses available for capital expenditure in the central and local government budgets. To this end high rates for savings deposits (3 to 9 per cent according to maturity) were fixed. The results achieved were poor. Even conceding the attractiveness of high interest rates, conditions—economic and political—were all against a favourable result. In April 1948, before the re-casting of the banking system, deposits totalled 1,440 million forint. Considerable as the rise was compared with the early post-stabilization period, the amount attained worked out at no more than 15 or 16 per cent of the total deposits in 1938 in terms of real value. But even in the inter-war period with bank credit on a normal scale, no proper capital market to finance investment operated.

INTEREST RATES AND THE DIRECTION OF INVESTMENT

In a system in which investment and savings are determined by the decisions of a central authority, no functional connexion exists between interest rates and the volume of investment. It rests with the central authority to fix interest rates arbitrarily, or to renounce the use of interest altogether. The Hungarian planners decided that the Investment Bank should allot long-term capital to public enterprises free of interest, except that a token rate of 1 per cent could be charged, apparently to cover the costs of running the bank. For co-operatives and applicants that are partly publicly owned, the rate of interest on capital borrowed from the Investment Bank amounts to 3 to 5 per cent. Other debtors, i.e. private enterprise, are charged with 7 to 10 per cent. By far the greatest part of the investments financed from the budget through the instrumentality of the Investment Bank comes under the first head, and does not bear interest.

In contrast with this practice, interest is charged on short-term credit to finance working capital, for public as well as for private enterprise. According to arrangements put in force under the Plan the interest rate amounted to 5 per cent for nationalized enterprises, to 12 per cent for other industrial enterprises, and to 18 per cent for commercial firms. It may be mentioned that prior to the war a rate of 12 per cent was not unusual for normal bank credit (inclusive of the margin earned

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652 453 by the private banks). When the private banks disappeared, the differential rates were directly charged by the National Bank.

The following special interest rates were in force for agriculture:

	per cent
(1) For co-operatives running collective farms	5
(2) For other co-operatives and for members of co-operatives in category (1)	9
(3) For members of co-operatives in category (2)	11
(4) For other debtors	18

The scale of interest rates can hardly be said to have been inspired by purely economic considerations. It was rather on political grounds that private enterprise had to bear considerably higher rates than that which had been nationalized. In agriculture the Government were intent on favouring collective farming by discriminative credit practices. 'Working' peasants were allowed to obtain credit on conditions similar to those prevailing before the war. For others (excluded from the co-operatives) a prohibitive rate of 18 per cent was fixed, though it was hardly more than nominal since those owning holdings over [661] 25 yokes were denied credit facilities. One decisive consideration was, apparently, to exploit even rates of interest as a weapon of class warfare.

652 454 In a capitalist system based on free competition, the investment market determines the allocation of resources among the various openings for capital enterprise, and the long-term rate of interest is its principal instrument for the purpose. The Hungarian Plan rejected that mechanism, and the question remains by what considerations the Government or the Planning Department was guided in deciding upon the allocation of capital resources among industries. At the inception of the Plan there was hardly any alternative to deciding arbitrarily upon the direction of investment into the various channels in conformity with preconceived ideas about the relative importance of capital-goods industries and of some outstanding consumer-goods industries. But as, in the course of economic progress, the application of the Plan became more and more intricate, this first rough approach had to be superseded by more discriminating methods. Under conditions when production provides only for bare necessities a programme based on nothing better than guesswork will contribute to meeting consumers' needs. As soon as the economy progresses beyond this low standard, divergencies between the anticipations of the planners' and consumers' wants are likely to arise.

652 475 The exemption of publicly-owned enterprises from being charged with interest on their investment would not itself pre-

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471 sales were arranged with the knowledge and, in some instances, with the support of the public authorities, though the initiative, as a rule, came from the industry concerned. The expedient most frequently applied, however, was the postponement of less urgent commitments. The criterion of urgency was whether a postponement of payment would or would not stop production. Tax payments were suspended, as were disbursements to suppliers of raw materials, who were not in a position to threaten to interrupt deliveries immediately needed. These practices indicate the intensity of pressure brought to bear on production. Postponement of meeting obligations, while helping individual concerns to overcome momentary embarrassment, was bound to affect the financial system at other points. Tax revenue would fall into arrears, or repayments of advances by some of the suppliers concerned would be postponed. To a certain extent the method of fixing a ceiling for the note issue may have retarded monetary expansion, but it could not stop it.

453 652 [647] Inside the credit administration there was a fundamental change in the position of the National Bank. The shaping of credit policy in the Committee for Credit Allocation rested with the representatives of the Supreme Economic Council's Secretariat, the Ministry of Finance, and the Planning Department. The members of the different Government Departments (Industry, Agriculture, Public Works) represented sectional interests. The National Bank with its delegate in the Committee provided at the same time the Secretariat of the latter. This secured the Bank an important position within the Committee though chiefly in a technical sense. For amounts not exceeding 10,000 forint (£200) the Committee delegated to the Bank its power of deciding upon the allocation of credit. The Committee itself was authorized to decide on individual loans up to 1 million forint. Above this limit decisions were reserved to the Supreme Economic Council.

The National Bank was not obliged to grant loans approved by the Committee. The Bank was expected to act with the circumspection of an ordinary banker in examining the solvency of the debtor and other circumstances which might influence the security of the credit. On such grounds the Bank had discretion to refuse credits which had been approved. The practical importance of this remnant of a credit policy of its own declined, however, with the spread of public concerns with Government-guaranteed liabilities.

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TIGHTENING CONTROLS

It was intended from the outset to place the conduct of business, whether of private or of public concerns, under a strict financial control. Full use was made of accountancy to examine the relation of cost and prices, and general issues of rationalization (in so far as publicly-owned enterprises were concerned), and there were investigations on special questions such as the use of loans. But financial control, as conceived in the second phase of the Three-year Plan, went far beyond the limits of elaborate accountancy. The reshaping of the entire banking system, started in the second quarter of 1948, was designed to establish a permanent current control of every move of the enterprises.

The so-called single-account system was introduced to the end of organizing a huge unified financial department for all public enterprises and for those private concerns specially designated. Each had to open an account with the National Bank, through which receipts and expenditure and financial operations of every description had to pass. In order to ensure a closer control, the single account was sub-divided in accordance with the various items of the financial plans (raw materials, wages, taxes, investments, etc.). The National Bank, therefore, was in a position, by comparing receipts and disbursements with the financial plan of the enterprise concerned, to exercise a continuous check upon its conformity with the Plan. Evidently the whole complicated system was drawn up to ensure control in pursuance of the Plan. Instructions from the holders of the accounts are carried out by the National Bank in so far as they are found to be in accordance with their respective financial plans. Outlays will be allowed only if they accord with the relevant estimates. Moreover, the National Bank is given discretion to transfer, without the instructions of the holder of the account, amounts due for taxes or for any other liability. If he has not a balance sufficient to meet his liabilities at maturity, the debtor is required to pay a penalty at the rate of one per thousand per day on the arrears.

This system of supervision precluded the possibility of granting a credit or of borrowing, except through the instrumentality of the National Bank. Thus a credit monopoly was conferred on the Bank, and not only was any other source of credit excluded, but suppliers were even prohibited from allowing deferred payment to their customers. The National Bank had to be notified of the sale-purchase, in order to debit immediately the ingle account of the buyer, and to credit that of the seller.

As to the question to what extent this absurdly rigid system

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1948	*Total Index*	*Food*	*Clothing*
January	128·4	153·1	113·2
February	132·6	159·9	113·2
March	130·0	154·8	112·7
April	130·6	156·3	112·1
May	132·5	158·5	112·8
June	124·2	142·1	112·8
July	117·0	128·0	112·8
August	115·2	124·1	113·4
September	110·1	113·9	114·0
October	114·8	120·6	114·0
November	115·7	122·8	112·6
December	115·3	122·3	112·6
1949			
January	113·9	119·6	112·6
February	111·4	114·6	112·6

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TABLE V

FINANCE AND CREDIT

(1) *Budget*

	1937–8	*1946–7*	*1947–8*	*1949*
		million forint		
Total expenditure of which	6,215	3,701	6,300	13,000
Current on goods and services	5,755	2,265	3,758	—
International commitments	—	1,436	1,709	—
Plan investment	—	—	833	4,300
Total revenue of which	6,178	3,703	6,397	—
Current	6,084	2,891	6,047	—
Borrowing and other extraordinary	99	812	359	—

(2) *National Bank of Hungary*

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	Gold and Foreign Exchange	*Bills*	*Loans on Current Account*	*Advance to Treasury*	*Notes in Circulation*	*Sight Liabilities*	*Deposits*
				million forint			
1946							
31 August	278	374	—	—	356	147	—
31 December	338	495	—	342	968	161	—
1947							
31 July	501	920	—	340	1,592	93	—
31 December	501	1,663	—	340	1,992	319	—
1948							
31 July	452	1,730	779	340	2,224	334	730
31 December	556	50	5,981	337	2,817	29	3,691
1949							
31 July*	600	3	7,331	309	3,094	3	4,716
31 December	512	—	8,557	288	2,629	3	6,492

* Banking reform in progress.

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(3) *Total Deposits of Commercial Banks and Savings Institutions*

	million forint
1938	11,630
1946 August	81
December	435
1947 July	791
December	1,265
1948 July	1,432*

* Including 389 million forint held by the National Bank, the transfer of the assets and liabilities of the other banks to the National Bank being in progress.

same authority, is unfortunately not available in this country. 185 X

The analysis of the Three Year Plan is thus based on material that leaves very much to be desired. However, where possible, indication was given of progress made in the interwar period and during World War II and it is hoped that these data, not generally accessible, will supply a background for a realistic appraisal of the plan and its achievements.

Machinery of the Plan[1]

The plan, in the form accepted and made into law, contained only broad outlines. However, machinery was set up to work out the details and to control the execution of the plan. This machinery provided a National Planning Board, an advisory body consisting of an equal number of representatives of all the parties of the government coalition and representatives of various organizations like the Trades Union Council, National Center of Cooperatives, etc. Its resolutions were not binding unless endorsed by the Supreme Economic Council or the Cabinet. 471

The actual work of elaborating the details of the national plan and coordinating within its framework the plans which the individual establishments had to prepare was the duty of the National Planning Office, a government department. When set up, its head was a collaborationist Social Democrat and its secretary-general was a Communist. Most, if not all, key posts were filled by Communists. The Planning Office was given power to control all investments. None of any size could be made by any corporation, not even out of its own funds, without the permission of the Planning Office.

To control the execution of the plan, each establishment was required to appoint a plan agent whose duty was to report on progress made and factors preventing or retarding progress.[2] The Investment Bank, set up to replace one of the nationalized commercial banks, was an additional instrument of control. However, as it had no funds and no policy of its own, it was only the accountant and the cashier of the Planning Office. More important was the role of the reorganized Bank of Issue which became the banker of nationalized industry with special functions and powers. [454] [453]

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our People," Social Review, Vol. V, No. 3 (1950), pp. 131-151.

2. Early in 1949, after the large-scale nationalization of industry, the plan agents were removed and their functions were transferred to the managers of the establishments who were appointed by the government.

1 [i.e. the Three Year Plan of 1947-1949]

461 The statement[1] complained about lack of discipline, both at the workshop and at managerial level, inefficient planning in the central agencies, and slackness in enforcing government directives. As a result, the high standard of living was endangering the execution of the investment program and dangerous lags were showing in fulfilling the plan. In foreign trade, during the 439 first four months of 1950, imports increased by 56 percent over the corresponding period of 1949 while the increase in exports was only 1 percent.

453 Signs of strain were indeed evident despite efforts to conceal them. One of these was the cessation of publication of the only continuous series still available in the periodic statements of the Central Bank giving the note circulation, bank reserves, savings, assets, and liabilities of the current account of nationalized industry.

433 In Hungary the early part of the year is usually noted for higher prices as the stocks of food and supplies decline before the new crops begin to come in. This year a severe drought damaged most crops. The whole six months' period was characterized by a marked deterioration in the food situation. Important staples, like potatoes, lard, meat, milk products, vegetables which had been available in sufficient quantities since 1947-48, were in short supply. The official explanation blamed higher consumption for the shortages, but admitted also the failure of the new national enterprises responsible for the distribution and hinted at the withholding of food by a resentful peasantry. In some cases, notably that of butter, the capitalist West was blamed because it wanted food against essential machinery. Unofficial information spoke of forced food exports to Eastern Germany and stockpiling for an emergency.

Under such conditions, it seemed unlikely that the standard of living could have improved as fast as had been claimed, at any rate in the course of 1950. At the same time, the stresses and dangers must have been very real if judged by the scope and severity of the measures that were introduced to counteract them. Very great efforts were made to bring in the harvest and have it in the safekeeping of the government. It was decided to strengthen the state-controlled sector of agriculture and notably to build up a systen of state dairy farms and fattening plants around the capital to ensure safe supplies of milk and other animal products. Large-scale purges were organized in trade-
661 unions and factories to improve discipline and increase output.
362 Efforts were made to encourage private savings by the launching of a cooperative housing scheme followed up with much vigor.

[1] [Statement of the Chairman of the People's Economic Council, cf. Cat. 116, P. 61 — Analyst]

a long time the state was not in a position financially to restore even fractionally the original value of the war bonds, but the bondholders of limited means received Government assistance. State expenditure under this heading has amounted to 60 million pengős since 1928. The war bonds were revalued in 1942 by Act of Parliament. The bonds are now worth 5% of their original value except those of small denominations, which can be cashed at 10% of their original value. Those who were entitled to Government assistance from their war bonds will continue to receive such grants-in-aid.

Protection of the small investor.

The interests of the small investor required governmental aid at other times. The Hungarian banking institutions survived the many economic depressions (with the exception of the post-war inflation) without serious disturbance to their financial structure and without inflicting a loss on their depositors. After the consolidation of public finances it seldom became necessary for the Government to intervene on behalf of the depositors, except in the case of banks in the re-occupied territories. The Government had to render financial assistance to these to tide them over the period of re-organization. Only when the Phönix Insurance Company collapsed was there some danger of many small investors suffering losses, but steps taken by the Government averted the danger and put the whole insurance system on a sounder basis.

Social Housing Projects.

The problem of adequate housing for the industrial population in urban districts became acute during the